



89-SBE-013

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BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
ESTATE OF LINDSAY C. HOWARD,) No. 83R-0754-CD
WILLIAM H. HAIR, MARY W.)
SULLIVAN, ET AL.)

Appearances:

For Appellant: Kent M. Kellegrew
Attorney at Law

For Respondent: Karen D. Smith
Counsel

O P I N I O N

This appeal was originally made pursuant to section 185931/ of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of the Estate of Lindsay C. Howard, William H. Hair, Mary W. Sullivan, et al against a proposed assessment of additional personal income tax and penalty in the total amount of \$11,487.65 for the taxable year ended August 31, 1979. Subsequent to the filing of this

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue..

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appeal, appellants paid the proposed assessment in full. Accordingly, pursuant to section 19061.1, this appeal is treated as an appeal from the denial of a claim for refund.

The issue presented by this appeal is-whether the Estate of Lindsay C. Howard (Estate) was entitled to a California income tax deduction for interest that it paid on delinquent inheritance taxes.

Lindsay C. Howard (Decedent) died testate on September 6, 1971. The Decedent's will directed in pertinent part that inheritance and other death taxes were to be paid out of the residue of his estate and charged as part of the estate's expenses of administration. The will was silent regarding payment of interest and penalties.

Because the Estate's assets consisted primarily of a horse ranch in Ventura County, the California inheritance taxes were not paid until the ranch was sold and funds were available. Interest accrued on the unpaid inheritance taxes and, when the inheritance taxes and accrued interest were finally paid, the Estate claimed an interest deduction of \$111,306 on its fiduciary income tax return for the year ended August 31, 1979. Upon review, the Franchise Tax Board (FTB) disallowed the interest deduction. The FTB also assessed a delinquent filing penalty which the Estate does not contest on appeal.

The FTB based its disallowance of the interest deduction on authorities contained in its Legal Ruling 421 (LR 421), dated March 9, 1982. The FTB determined that: (1) liability for payment of inheritance taxes is statutorily imposed on the executor of an estate, and ultimately on the respective beneficiaries, but not on the estate itself; (2) an estate may not deduct interest that it has paid on delinquent inheritance taxes which it was not obligated to pay; and (3) a testamentary direction that bequests pass free of inheritance taxes is not effective to shift to the estate liability for payment of these taxes and to create in the estate the concomitant right to deduct interest paid as a result of the taxes' delinquent status. Appellants appear to contest only the third of these determinations.

Although the Decedent's directions in his will are not completely explicit, we read them as requiring that nonresiduary legatees receive their respective bequests free of inheritance taxes, which will be paid instead from the residue of the Estate. (See Estate of Cochran, 30 Cal.App.3d. 892, 894-895 [106 Cal.Rptr. 700] (1973).) A number of cases cited by appellants contain language that on first consideration appears to

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support appellants' position that liability for payment of inheritance taxes is shifted to the Estate by directions such as those in the Decedent's will.

Appellants rely heavily on Estate of McLaughlin, 243 Cal.App.2d 516, 521 [52 Cal.Rptr. 543] (1966), which states as follows:

A testator may by specific language direct a bequest to be paid to the beneficiary free of inheritance tax. (Estate of Nesbitt, 158 Cal.App.2d 630, 632 [323 P.2d 474]; Estate of Anthony, 230 Cal.App.2d 766, 774 [41 Cal.Rptr. 317].) In such case, the tax is borne by the estate rather than the legatee.

The foregoing proposition in McLaughlin is embraced, and its language essentially reiterated, in Estate of Hendricks, 11 Cal.App.3d 204, 207 [89 Cal.Rptr. 7481 (1970)], and Estate of Linder, 85 Cal.App.3d 219, 223 [149 Cal.Rptr. 3311 (1978)].

However, the FTB has argued that testamentary language intended to pass nonresiduary bequests undiminished by inheritance taxes does not shift liability for payment of these taxes to the estate, but merely transmutes them into an additional legacy and identifies the residue of the estate as the source from which this legacy is to be paid. Our close reading of the authorities on which Estate of McLaughlin and its associated cases rely convinces us that these authorities do not support the proposition that such testamentary direction creates an obligation in an estate to pay inheritance taxes. (See Estate of Nesbitt, 158 Cal.App.2d 630 [323 P.2d 474] (1958) and authorities cited therein.) As a result, we believe that the FTB's argument is correct. Consequently, the Estate is not entitled to deduct interest paid on delinquent inheritance taxes because the Estate had no obligation to pay these taxes.

For this reason, and because appellants have not attempted to show why they should be relieved of the delinquent filing penalty, the action of the FTB must be sustained.

